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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1949.

LOLA BROOKS, Administratrix of the Estate of F. S. Brooks, Deceased,
Petitioner,
vs.
ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY, a Missouri Corporation,
Respondent.

No. 777.

BRIEF

In Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

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In Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Respondent emerged from reorganization under Section 77 of the Bankruptcy Act by virtue of a Consummation Order and Final Decree entered December 12, 1946, by the District Court of the United States for the Eastern District of Missouri. In said Consummation Order and Final Decree jurisdiction was reserved to the Court to pass on any undetermined claims theretofore filed for priority over mortgages existing on the debtor's property (R. 7). In

the reorganization the interests of the old stockholders were entirely wiped out. They were allowed no interest whatever in the reorganized company. Likwise, all ordinary unsecured claims were wiped out and no interest was allowed to the holders thereof in the reorganized company. The assets of the old company were found insufficient to satisfy in full all claims secured by mortgages. See **St. Louis-San Francisco Ry. Co. Reorganization,** 257 ICC 399, 409-410, 435 (1944), and **In re St. Louis-San Francisco Ry. Co.,** 59 FS 417, at 419 (D Ct Mo, 1945), affirmed in **Brooks v. St. Louis-San Francisco Ry. Co.,** 153 F 2d 312; certiorari denied, 328 US 867, 868.

The claim at bar is an unsecured claim which petitioner asserts is entitled to priority. The origin of the claim and its disposition in the Court below are hereinafter set forth.

OPINIONS BELOW.

The opinion of the District Court dated June 29, 1949, is unreported. It appears in the Record at pages 31 and 33. The opinion of the Court of Appeals dated March 3, 1950, is reported in 180 F 2d 185. It appears in the Record at pages 43-49.

JURISDICTION.

The petitioner invokes the jurisdiction of this Court under Article III, Section 2, of the Constitution, and Title 28, United States Code, Section 1254 (1).

STATUTE INVOLVED.

Section 77 of the Bankruptcy Act governs the proceedings in which the claim at bar arose. The relevant subsections of said Section 77 are subsection (b) and subsection (n). The relevant portion of subsection (b) appears on p. 4 and subsection (n) is printed in the Appendix to this Brief.

QUESTION INVOLVED.

The question involved in this case is whether a claim for personal injury sustained prior to the bankruptcy of a railroad company by a claimant who was neither an employee nor a passenger of the debtor is entitled to priority of payment over claims secured by pre-existing mortgages on the debtor company's properties.

THE RELEVANT FACTS.

The claim arose out of a collision on January 30, 1930, at a highway-railroad grade crossing between one of the Railway Company's trains and an automobile which Brooks was driving (R. 37). Brooks reduced his claim to a judgment against the St. Louis-San Francisco Railway Company for $4,000 in a Missouri court on January 23, 1933, by consent of receivers who had been appointed in November, 1932, for the Railway Company's property (R. 38). Later the receivership was supplanted by proceedings for reorganization under § 77 of the Bankruptcy Act. No judgment was ever entered, by consent or otherwise, against the receivers or their successor trustees. In the reorganization proceedings the claim on the judgment was allowed as an unsecured claim (R. 2). Brooks later died, and his administratrix, petitioner here, moved the District Court to allow the unsecured claim in priority over the Railway Company's pre-existing mortgages, constituting liens on all its properties and income (R. 9).

The District Court denied the motion to allow the claim as one having priority over the mortgages (R. 33) and the Court of Appeals affirmed the order of the District Court (R. 50).

ARGUMENT.

POINT I.

The Judgment of the Court of Appeals Affirming the Order of the District Court Was in Accordance With Law, and No Ground for Granting a Writ of Certiorari to Review That Judgment Has Been Shown.

The petitioner's right to an allowance of this unsecured claim in priority over mortgages of the Railway Company is governed by subsection (b) of Section 77 of the Bankruptcy Act which makes the law of equity receiverships applicable to such claim. It provides:

> "For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the Debtor had been appointed by a Federal Court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

It is a basic principle of the law that unsecured claims against a debtor may not be satisfied or paid in priority over a mortgage on the debtor's property, out of assets subject to the mortgage, upon its foreclosure.

An exception to that fundamental principle was created in equity receiverships and on equitable grounds in **Fosdick v. Schall**, 99 US 235 (1878), in which the opinion was delivered by Mr. Chief Justice Waite. Shortly thereafter, in 1884, in **Burnham v. Bowen**, 111 US 776, at 783, he explained that only those expenses which were **"for the benefit of mortgage creditors"** fell within the exception to the rule that unsecured claims generally are subordinate to mortgage liens. And, as the Court below pointed out, "it is probable that he used the term 'current debts made in

the ordinary course of business' in the opinion in **Fosdick v. Schall,** supra, in the same sense, for in that case priority was denied a claim for rental for cars over the lien of an antecedent debt."

Since claims arising out of the negligence of the debtor are not for the benefit of the mortgage creditors, but rather a detriment to them, it has been uniformly held in the federal courts that such claims remain in the general class of unsecured claims which are subordinate to liens on the debtor's property. They are not within the exceptional class recognized in **Fosdick v. Schall,** because not within the reason and equity on which that class rests. The rulings of the federal courts on this question are set forth in the opinion of the Court below (R. 46-47). The decision in **St. Louis Trust Co. v. Riley,** 70 F 32, holding that a personal injury claim based on the negligence of the debtor is not entitled to priority, was, as Judge Learned Hand said, "unquestionably the law when Section 77 was passed." **In re New York, New Haven & Hartford R. Co.,** 92 F 2d 428, 430; certiorari denied 303 US 650.

Hence, this rule governs in reorganization proceedings under § 77, for by force of subsection (b) thereof unsecured claims in § 77 proceedings are entitled to the same priority as that accorded in equity receiverships. The legislative intent in this connection is emphasized by the fact that the class of exceptions entitled to priority has been carefully regulated and has been enlarged by Congress in Section 77 to include only two additional classes of cases. These enlargements, created by subsection (n), are:

(1) Employees' claims in § 77 proceedings for personal injury.

(2) Surety claims in § 77 proceedings payable by sureties on supersedeas and like bonds.

By Act of Congress approved August 11, 1939, 53 US Stat. 1406, these two additional classes were accorded

priority in equity receivership cases, as well as in § 77 proceedings.

It is perfectly clear that petitioner's unsecured claim is not within the class entitled to priority by virtue of the exceptions created in **Fosdick v. Schall** nor within the enlargement of those exceptions created by § 77 itself. The basis of the rule that benefit to the mortgagee is the controlling equitable consideration was again recognized by this Court in **New York Dock Company v. S. S. Poznan**, 274 US 117, at 121. The decision of the Court below is in complete accord with the decisions of this and all other federal courts which have passed on the question, as well as in accord with the governing statute. No occasion exists for the issue of a writ of certiorari.

The statements on page 4 of the petition herein as to payments of dividends in the years 1930 and 1931 are irrelevant to any equitable considerations here. Those dividends were paid to stockholders of the old company who retained no interest whatever in the property after the debtor's reorganization. The payment of such dividends, if prejudicial to unsecured creditors, was equally prejudicial to secured creditors since they would have had a lien on the funds prior to the unsecured creditors, if the funds had been retained as assets of the debtor.

POINT II.

Petitioner's Specification of Errors Is Without Substance.

Petitioner's first and second specifications of error relate to the principal question involved in this case. For the reasons stated in the foregoing portion of this Reply Brief, the decision of the Court below was in accord with the decisions of this Court and the provisions of the governing statute. These specifications of error are, therefore, entirely without substance.

Petitioner's third specification of error, taken in conjunction with the argument in support of the specifications, seems to be a confusion of the question of **what claims are entitled** to priority with the question of **what funds are subject to the payment** of priority claims. The reference to and the argument based on **Gilman v. Illinois and Mississippi Telegraph Co.**, and **United States Trust Co. v. Wabash Western Ry.**, on page 15 of petitioner's brief are obscure and uncertain. They seem to constitute a contention either (a) that there was a diversion of pre-receivership income constituting a current debt fund for the payment of priority claims, or (b) that the order for impounding and sequestration of income was not seasonably entered, leaving as unmortgaged assets certain income accruing prior to the impounding and sequestration order. But neither aspect demonstrates any error in the decision of the Court below or calls for the issuance of a writ of certiorari.

It is true that there is much discussion in the decisions of this Court and other federal courts with respect to the fund out of which priority claims may be paid.[1] It has been pointed out that:

> "The funds to which such priority attaches are unmortgaged property, pre-receivership operating income either on hand or subsequently collected by the receiver, net receivership operating income, and the corpus of the mortgaged property to the extent, but only to the extent, that pre-receivership or receivership income has been diverted for the benefit of the mortgage creditors." **The Present Status of the Six Months' Rule**, T. O'G. Fitzgibbon, 34 Col L R 230, 241-242.

But petitioner's argument in this regard rests upon a misconception of the priority rule in relation to the fund

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1 See cases cited in **The Present Status of the Six Months' Rule**, T. O'G. Fitzgibbon, 34 Col L R 230, 241-242.

out of which priority claims may be paid or satisfied. The so-called "current debt fund" is not subject to payment of petitioner's claim unless the claim has priority based upon some superior equity or statutory provision. A general unsecured claim becomes a charge on the "current debt fund" if, and **only if,** it has a superior equity or statutory foundation entitling it to priority. Petitioner's reasoning in this connection begs the question by assuming in the premise the desired conclusion. In short, it "puts the cart before the horse." The fallacy which leads to this illogical result was the main contention which petitioner pressed below, namely, that **all** operating expenses are entitled to priority; whereas in truth only operating expenses incurred **for the benefit of the estate** are within the rule. See **Fosdick v. Schall,** supra, and **Burnham v. Bowen,** supra, and **Pennsylvania Steel Co. v. New York City Ry. Co.,** 216 F 458, at 472-473, certiorari denied, 238 US 632.

On the other hand, if petitioner's argument means that the date of the entry of the impounding order was such as to leave certain income available as an unmortgaged asset for the payment of unsecured claims, petitioner's argument fails on two grounds: **First,** because it is **res judicata** that there were no unmortgaged assets available for the satisfaction of unsecured claims; and **second,** for the reason that the existence of a priority claim is not dependent upon the existence or non-existence of unmortgaged assets, as shown above, p. 8.

If petitioner now contends again that the claim at bar must be paid because of the existence of unmortgaged assets, that contention, besides being a complete abandonment of the legal basis of the claim urged in the District Court and the Court below and unsupported by the pleadings, was adjudicated adversely to petitioner on the appeal to the Court below from the District Court's order approv-

ing the plan of reorganization for respondent. The substance of petitioner's contention at that time and the disposition made of it by the Court below are set forth in **Brooks v. St. Louis-San Francisco Railway Company**, 153 F 2d 312, at 317, certiorari denied, 328 US 867-868, and need not be repeated here.

On the other hand, in the reorganization proceedings the question whether the claim at bar is entitled to priority was reserved for later determination. The case at bar is the result of that determination, which was, as held by the District Court and the Court below, that the claim has no priority. For the reasons stated hereinbefore, that determination was in accord with the decisions of this Court and with the applicable provision of Section 77.

CONCLUSION.

There is no ground shown for granting a writ of certiorari in the case at bar, and the petition for certiorari should be denied.

Respectfully submitted,

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Dated:

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May 11, 1950.

APPENDIX.

Prior to its amendment in 1939, subsection (n) of Section 77 reads as follows:

> "In proceedings under this section, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under State or Federal laws, and claims now, or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds executed by sureties without security for, and in any action brought against such railroad corporation or trustee appointed pursuant to this section, shall be preferred against and paid out of the assets of such railroad corporation as operating expenses of such railroad." 49 US Stat. 923, Approved August 27, 1935.

The Act of August 11, 1939, amended subsection (n) to read as follows:

> "In proceedings under this section, and in equity receiverships of railroad corporations now or hereafter pending in any court of the United States, claims for personal injuries to employees of a railroad corporation, claims of personal representatives of deceased employees of a railroad corporation, arising under State or Federal laws, and claims now or hereafter payable by sureties upon supersedeas, appeal, attachment, or garnishment bonds, executed by sureties without security, for and in any action brought against such railroad corporation or trustees appointed pursuant to this section, shall be preferred and paid out of the assets of such railroad corporation as operating expenses of such railroad." 53 US Stat. 1406, Approved August 11, 1939.